U. S. TREASURY DEPARTMENT
Washington 25

Jan. 8, 1954

[SEAL]

Office of
Commissioner of Internal Revenue

Address Reply To
Commissioner of Internal Revenue
And Refer To
T:R:C-AS
T:S:EX
LWP

Messrs. Dunnington, Bartholow & Miller
Chrysler Building East
161 East 42nd Street
New York 17, New York

In re: Request for a Ruling
Dorchester Corporation
Nalam Corporation
Cortez Oil Corporation

Gentlemen:

This is in reply to your letter of April 19, 1954, and to your letter of May 14, 1954, which presented additional information and modified the request for a ruling presented in your original letter. The facts upon which your request is based are as shown in your letters, in the Exhibits attached to your original letter, and as summarized briefly below.

Dorchester Corporation (hereinafter called Dorchester) will purchase certain assets, consisting of two gasoline plants in the Guymon-Hugoton Field in Oklahoma and Kansas and the Panhandle Field in Texas, respectively, together with a pipe-line gathering system, railway tank cars, trucks, etc., for $3,000,000 in cash and $3,500,000 in secured junior notes (payable later after certain terms are met) from five individuals (hereinafter called Sellers). Dorchester will agree to operate the plants for the purpose of processing gas from producing properties owned by Sellers in the fields mentioned and to pay over to owners of economic interests in the properties 45 percent of plant gross income, the payments to be reduced to 40 percent under certain stated circumstances.

Nalam Corporation (hereinafter called Nalam) will buy the producing properties for $37,000,000 subject to the processing agreement referred to, and subject to a Junior Gas Payment of $75,000,000 retained by Sellers commencing after Nalam shall have received out of the operation of the properties $38,000,000 net as set forth at pages 5 and 6 of your Exhibit B. The Junior production payment retained by Sellers will be payable out of 75 percent to 80 percent of Nalam's income from dry gas and will terminate prior to full payment if and when the estimated gas reserves under the properties declines below 100 billion cubic feet.

Nalam will execute a deed of trust, with the properties owned by it as security, in favor of First National Bank of Dallas acting as Trustee for Metropolitan Life Insurance Company and Mutual Life Insurance Company of New York. The insurance companies will loan Nalam $35,000,000. Nalam will pay the loan, plus 5 percent interest per annum on the unpaid principal balances payable monthly, plus 3⅛ percent deferred interest on the unpaid principal balances, which deferred interest becomes payable when the

unpaid balance of principal becomes due, at final maturity or by acceleration. When the accumulated deferred interest becomes due and payable it will begin to draw interest at 5 percent per annum until paid. Payments will be made out of a percentage of its proceeds from operation starting at 96 percent and later reducing to a minimum of 13 percent.

Nalam will, following the execution and delivery of the notes and deed of trust, but on the same day, assign all the leaseholds and equipment to Dorchester, subject to the deed of trust, the processing agreement and the junior production payment, for $2,000,000, and will retain a "Senior Gas Payment". Nalam's Senior Gas Payment will consist of an amount equal to accumulated legal fees and other expenses, payable out of 96½ percent of its production, plus a primary amount equal to $35,250,000 and an amount equal to interest at 5 percent per annum on the unliquidated balances payable out of 96½ percent of production, plus a secondary amount of (a) $100,000, (b) an amount equal to accumulated interest on $35,000,000 at 3⅛ percent per annum to completion of payment of the primary amount, and (c) an amount equal to interest at 5 percent per annum on the unliquidated balances of (b) beginning after payment and discharge of the primary amount. The secondary amount will be payable out of smaller fractions of production, commencing after payment and discharge of the primary amount. The $2,000,000 received from Dorchester plus the $35,000,000 borrowed from the insurance companies will constitute the source of the $37,000,000 to be paid by Nalam to Sellers.

In the final transaction Nalam will assign its retained Senior Gas Payment, subject to Nalam's obligations under the notes and deed of trust, to Cortez Oil Corporation (hereinafter called Cortez), which will pay Nalam $25,000 cash and will pay all expenses incident to the transaction.

At the conclusion of these transactions Nalam will have received $25,000 for performing the functions outlined above, will retain no interest in the gas in place or in the tangible properties, and will be relieved of all liabilities for any of the obligations incurred. Until the principal amount of the loans have been repaid and assuming no events of default have occurred, 96 percent of the proceeds of production, including that portion of the sale price of the liquefied products attributable to the leases, will be applied by the trustee on the Notes, ½ percent will go to Cortez as the owner of the Senior Gas Payment (which is payable out of 96½ percent of production) and 3½ percent will go to Dorchester. Dorchester will operate the leases and will be obliged to pay operating expenses and ad valorem taxes. It will have no personal liability on the Notes and the Lenders can look to Dorchester's share of the proceeds of production for application on the Notes only in case of default.

You ask that a ruling be issued to the following effect:

1. The Senior Gas Payment reserved by Nalam will be a depletable economic interest in gas in place and will retain this character in the hands of Cortez. Cortez will be entitled to use cost depletion as a deduction from the gross income generated by the Senior Gas Payment.

2. Cortez' cost for the Senior Gas Payment will be equal to the principal amount of the indebtedness represented by the Notes which it assumed, plus $25,000 and the other liabilities assumed and costs incurred by Cortez in acquiring the Senior Gas Payment.

3. Nalam's cost in the properties purchased from Sellers is allocable between the interests sold to Dorchester and the interest represented by the Senior Gas Payment

which Nalam reserved and sold to Cortez, such allocation being made in accordance with the respective fair market values of the two interests sold. Each of such two sales by Nalam is a taxable event and the total income or gain taxable to Nalam in the transactions in question will be the sum of the profits resulting from the two sales, which, under the facts stated in taxpayer's application, appears to amount to $25,000.

4. No part of the income from that production applicable to the Senior Gas Payment or to the Junior Gas Payment will be taxable to Dorchester since all such production will be excludable from the gross income of Dorchester.

5. To the extent that Dorchester pays out of income from production ad valorem taxes and similar assessments attributable to the value of the Senior Gas Payment owned by Cortez, the payments so made will be excluded from the gross income of Dorchester and will constitute additional depletable income to Cortez attributable to the gas payment.

6. Since Dorchester will be deemed to have paid such taxes as the agent of Cortez, the amounts of such taxes will be deductible by Cortez.

7. Similarly all such ad valorem taxes or assessments applicable to the Junior Gas Payment reserved by Sellers which are paid by Dorchester out of production also will be excludable from the gross income of Dorchester and from the gross income of Cortez.

Based upon the statements of fact in your letters and exhibits attached thereto, it is held that:

1. The assignment by Nalam of the properties to Dorchester in a transaction whereby it will receive cash and will retain a contingent gas payment will constitute

a sale of a portion of the property and a retention of a depletable economic interest (Thomas V. Perkins, 301 U.S. 655, which held that a contingent production payment paid out was not includable in the payor's (operators) gross income). The disposal of that interest to Cortez will not change its character as a depletable economic interest subject to the depletion allowance under section 39.114(b)(3) of Regulations 118.

2. Cortez' cost for the Senior Gas Payment will be equal to the principal amount of the indebtedness represented by the Notes which it assumed, plus $25,000 and the other liabilities assumed and costs incurred by Cortez in acquiring the Senior Gas Payment.

3. Nalam's cost in the properties purchased from the original owners is allocable between the interests sold to Dorchester and the interest represented by the Senior Gas Payment which Nalam reserves and sells to Cortez, such allocation being made in accordance with the respective fair market values of the two interests sold. Each of such two sales by Nalam is a taxable event and the total income or gain taxable to Nalam in the transactions in question will be the sum of the profits resulting from the two sales, which, under the facts stated in the request for a ruling, appears to amount to $25,000.

4. The Senior Gas Payment has been defined above as an economic interest, depletable in the hands of the owner. The Junior Gas Payment is identical to the Senior Gas Payment in its characteristics. Neither is includable in Dorchester's gross income (Thomas v. Perkins, 301 U.S. 655).

5. Ownership by Cortez of the Senior Gas Payment represents ownership of gas in place. To the extent that ad-

valorem and similar taxes paid by Dorchester apply to Cortez' share in the ownership of the property the payments by Dorchester will be excludable from Dorchester's gross income (GCM 26526, C. P. 1950-2, 40), and includable in the depletable gross income of Cortez.

6. The payments by Dorchester for the benefit of Cortez, referred to above, will be deductible by the latter in computing net income from proceeds of the contingent production payment, to the extent such payments are deductible for income tax purposes.

7. The same principles (5 and 6 above) will apply to the Junior Gas Payment to be reserved by the original owners upon assignment of the leases to Nalam.

Very truly yours,

/s/ H. T. Swartz

Director, Tax Rulings Division

Harrington & Marsh, et al, owners of leaseholds, gas plants, etc. enter into Gas Purchase Contract with Natural Gas Pipeline Company of America dated as of December 1, 1946.

↓

Leaseholds, gasoline plants, etc. and Contract assigned to Panoma Corporation as of October 1, 1948.

↓

July 1, 1954, Panoma Corporation dissolved. All assets distributed to stockholders, i.e. Harrington & Marsh, et al.

Stockholders, Harrington & Marsh, et al, convey gasoline plants and gatherings system, automotive equipment, etc., but not leaseholds, wells or well equipment, to Dorchester Corporation for 6-1/2 million dollars. Dorchester borrows 2-1/2 million dollars on 5-year note from Chase National Bank and gives first mortgage on gasoline plants secured by a Mortgage and Deed of Trust from Dorchester to Donald Scott, Jr., Trustee, dated as of July 1, 1954. Loan repayable at rate of $125,000 per quarter commencing October 1, 1954. Sellers reserve 3-1/2 million dollars purchase money note on which principal payments of $125,000 per quarter, but not interest payments, are deferred until October 1, 1959, unless Chase loan is paid off prior to July 1, 1959, in which event quarterly payment commences on quarter following discharge of Chase loan. Provision made for net cash income sinking fund commencing in 1955.

Stockholders, Harrington & Marsh, et al, enter into Processing Agreement with Dorchester Corporation, now owners of gasoline plants and gathering system, covering the gathering of the gas, the extraction of liquids and delivery of residue to Natural. Leasehold interests to receive 45% of liquids attributable to "owners' gas" for 5 years and thereafter until weighted average price of gas reaches 12¢ at 14.65 psia, then leasehold interest to receive 40%. Plant owner to pay to leasehold interest for plant fuel and shrinkage on basis of the price received from the pipeline purchaser for residue.

↓

Gasoline plants and gathering system owned by Dorchester subject to first mortgage held by Chase National Bank and second mortgage held by stockholders, i.e. Harrington & Marsh, et al, and burdened with obligations under Processing Agreement.

Stockholders, owners of leasehold interest, convey leaseholds to Nalam Corporation for 37 million dollars in cash, reserving the below sea level horizons and a deferred production payment in the amount of 75 million dollars payable from 80% of net wellhead volume of gas attributable to leasehold interests produced until 10 million dollars had been recovered thereunder, then out of 75% of net wellhead volume of gas attributable to leasehold until full payment is discharged or gas reserves reach a minimum of one hundred billion feet. Deferred production payment of 75 million dollars commences when total leasehold proceeds net to working interest (including liquid value, plant fuel and shrinkage payment under Processing Agreement) shall have produced 38 million dollars with interest at 5% per annum. Nalam also acquired the liquid value payment, plant fuel and shrinkage payment payable to owners of leasehold interest under Processing Agreement.

↓

Nalam mortgaged all interests acquired by it to Metropolitan Life Insurance Company and Mutual of New York to secure a loan of 35 million dollars for a term of 15 years at 5% interest, plus 3-1/8% simple deferred interest which accrues and is payable when the final installment on the loan is due. The matured amount of the deferred 3-1/8% interest is subject to 5% annual penalty interest. The lien is evidenced by the Deed of Trust, Mortgage and Assignment from Nalam to First National Bank in Dallas, Texas, dated July 1, 1954.

↓

Subject to the Deed of Trust to First National Bank in Dallas, the Processing Agreement, and deferred production payment reserved by stockholders, i.e. Harrington & Marsh, et al, Nalam conveyed leaseholds and rights acquired from stockholders to Dorchester for 2 million dollars in cash. Dorchester assumed the obligations to operate the leaseholds but did not assume the mortgage. Nalam reserved the following in such conveyance:

(1) From 96-1/2 percent of the production the sum of $434,250.
(2) From 96 percent of the production after $434,250 shall have been received, the sum

$35,000,000 payment at 5 percent, from 13 percent of the production for the following ten years, from 14 percent of the production for the next ten years, from 19 percent of the production thereafter, the amount of the deferred matured interest at 5 percent plus the sum of $100,000.
(4) From 1/2 of 1 percent of the production com-

October 1, 1959, unless Chase loan is paid off prior to July 1, 1959, in which event quarterly payment commences on quarter following discharge of Chase loan. Provision made for net cash income sinking fund commencing in 1955.

Stockholders, Harrington & Marsh, et al, enter into Processing Agreement with Dorchester Corporation, now owners of gasoline plants and gathering system, covering the gathering of the gas, the extraction of liquids and delivery of residue to Natural. Leasehold interests to receive 45% of liquids attributable to "owners' gas" for 5 years and thereafter until weighted average price of gas reaches 12¢ at 14.65 psia, then leasehold interest to receive 40%. Plant owner to pay to leasehold interest for plant fuel and shrinkage on basis of the price received from the pipeline purchaser for residue.

Gasoline plants and gathering system owned by Dorchester subject to first mortgage held by Chase National Bank and second mortgage held by stockholders, i.e. Harrington & Marsh, et al, and burdened with obligations under Processing Agreement.

in cash, reserving the below sea level horizons and a deferred production payment in the amount of 75 million dollars payable from 80% of net wellhead volume of gas attributable to leasehold interests produced until 10 million dollars had been recovered thereunder, then out of 75% of net wellhead volume of gas attributable to leasehold until full payment is discharged or gas reserves reach a minimum of one hundred billion feet. Deferred production payment of 75 million dollars commences when total leasehold proceeds net to working interest (including liquid value, plant fuel and shrinkage payment under Processing Agreement) shall have produced 38 million dollars with interest at 5% per annum. Nalam also acquired the liquid value payment, plant fuel and shrinkage payment payable to owners of leasehold interest under Processing Agreement.

Nalam mortgaged all interests acquired by it to Metropolitan Life Insurance Company and Mutual of New York to secure a loan of 35 million dollars for a term of 15 years at 5% interest, plus 3-1/8% simple deferred interest which accrues and is payable when the final installment on the loan is due. The matured amount of the deferred 3-1/8% interest is subject to 5% annual penalty interest. The lien is evidenced by the Deed of Trust, Mortgage and Assignment from Nalam to First National Bank in Dallas, Texas, dated July 1, 1954.

Subject to the Deed of Trust to First National Bank in Dallas, the Processing Agreement, and deferred production payment reserved by stockholders, i.e. Harrington & Marsh, et al, Nalam conveyed leaseholds and rights acquired from stockholders to Dorchester for 2 million dollars in cash. Dorchester assumed the obligations to operate the leaseholds but did not assume the mortgage. Nalam reserved the following in such conveyance:

(1) From 96-1/2 percent of the production the sum of $434,250.
(2) From 96 percent of the production after $434,250 shall have been received, the sum of $35,000,000 at 5 percent interest.
(3) From 10 percent of the production for five years commencing with the discharge of the $35,000,000 payment at 5 percent, from 13 percent of the production for the following ten years, from 14 percent of the production for the next ten years, from 19 percent of the production thereafter, the amount of the deferred matured interest at 5 percent plus the sum of $100,000.
(4) From 1/2 of 1 percent of the production commencing with the time that the $434,250 shall have been received and continuing until the $35,000,000 at 5 percent is discharged, and thereafter from 86-1/2 percent of the production, the sum of $250,000 at 5 percent interest

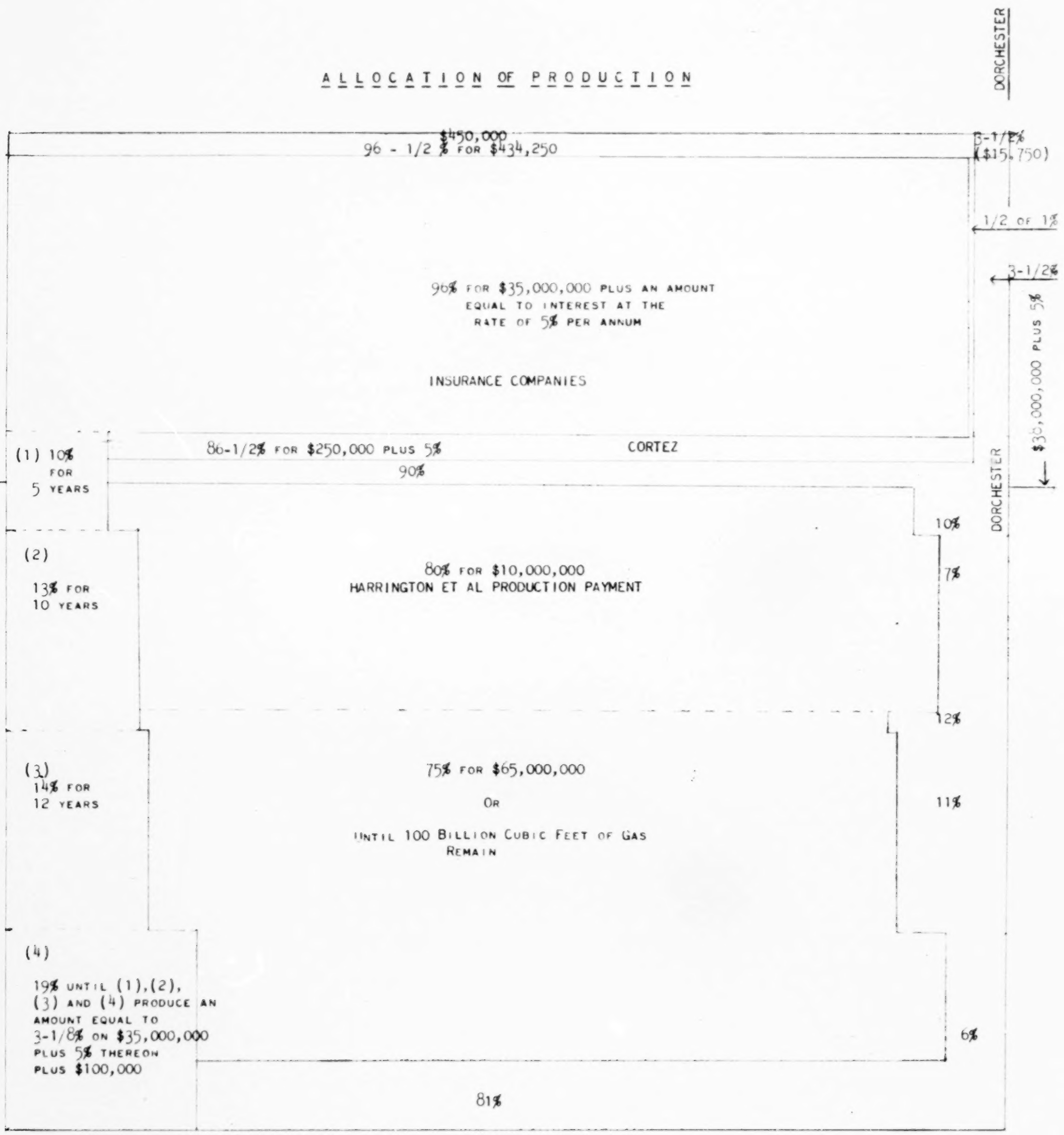
Leasehold interest held by Dorchester subject to the following in order as shown:

(1) Processing Agreement;
(2) Deferred production payment by stockholders, i.e. Harrington & Marsh, et al, in the amount of 75 million dollars;
(3) Mortgage and Deed of Trust to First National Bank in Dallas.
(4) Reservation in conveyance from Nalam to Dorchester, all interest of which is now owned by Cortez.

After conveyance to Dorchester, Nalam conveyed to Cortez Oil Corporation the reserved production payment as reserved in conveyance to Dorchester. Cortez assumed the debt and all obligations under the Mortgage and Deed of Trust securing the $35,000,000 loan from Metropolitan and Mutual.

FEDERAL POWER COMMISSION DOCKET NO. G-6505
IN THE MATTER OF DORCHESTER CORPORATION
EXHIBIT NO. 3

ALLOCATION OF PRODUCTION



EXPLANATIONS

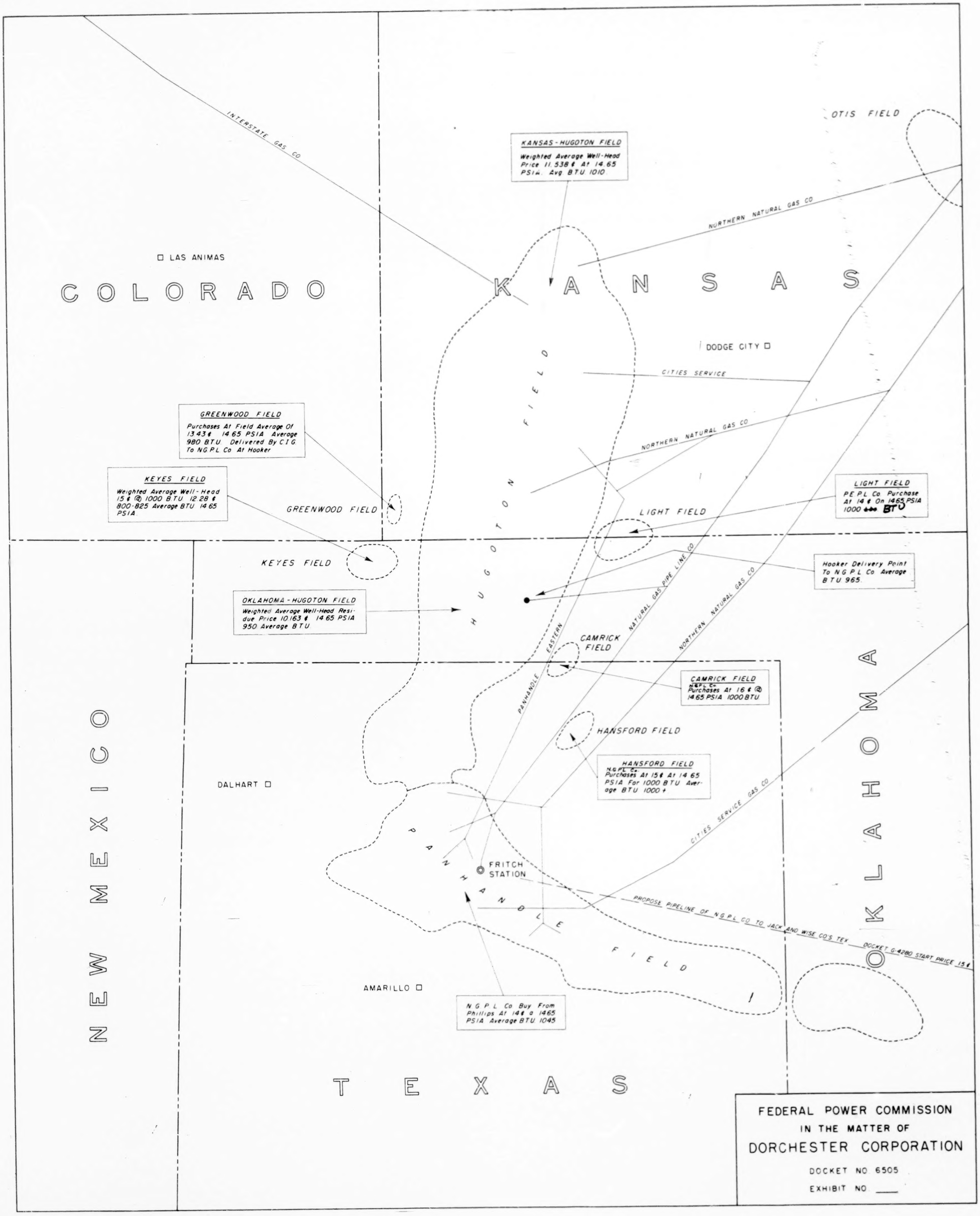
1. ALL OF THE PRODUCTION INDICATED EXCEPT THE HARRINGTON, ET. AL. PRODUCTION PAYMENT MORTGAGED TO SECURE THE LOANS MADE BY METROPOLITAN LIFE INSURANCE COMPANY AND THE MUTUAL LIFE INSURANCE.

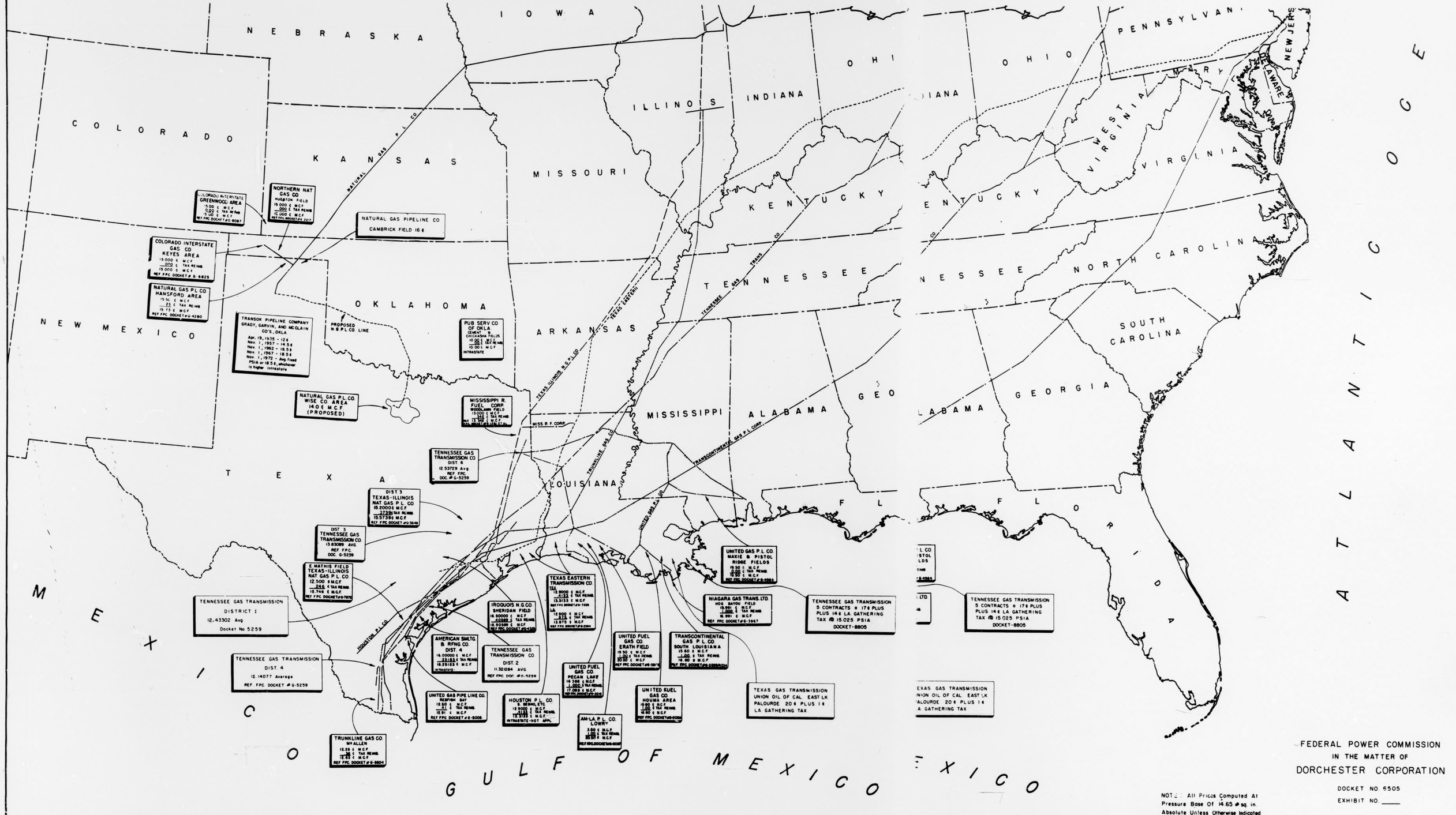
2. AFTER $35,000,000 PLUS 5 PERCENT REPAID TO INSURANCE COMPANIES LIEN SHRINKS TO THE 10% - 13% - 14% AND 19% INDICATED IN THE LEFT HAND COLUMN.

3. THE PRODUCTION PAYMENT RESERVED BY NALAM CORPORATION COVERS ALL OF THE PRODUCTION INDICATED EXCEPT: (I) THE HARRINGTON, ET. AL. PRODUCTION PAYMENT, AND (II) THAT PERCENTAGE OF THE PRODUCTION INDICATED IN THE RIGHT HAND COLUMN.

4. THE NALAM PRODUCTION PAYMENT INCLUDES 45 PERCENT OF THE LIQUIDS ATTRIBUTABLE TO "OWNERS' GAS" AS DEFINED IN THE PROCESSING AGREEMENT UNTIL THE WEIGHTED AVERAGE OF GAS SOLD EQUALS OR EXCEEDS 12¢ PER MCF AT WHICH TIME SUCH PERCENTAGE REDUCES TO 40 PERCENT.

5. THE HARRINGTON, ET. AL. PRODUCTION PAYMENT DOES NOT INCLUDE LIQUIDS.

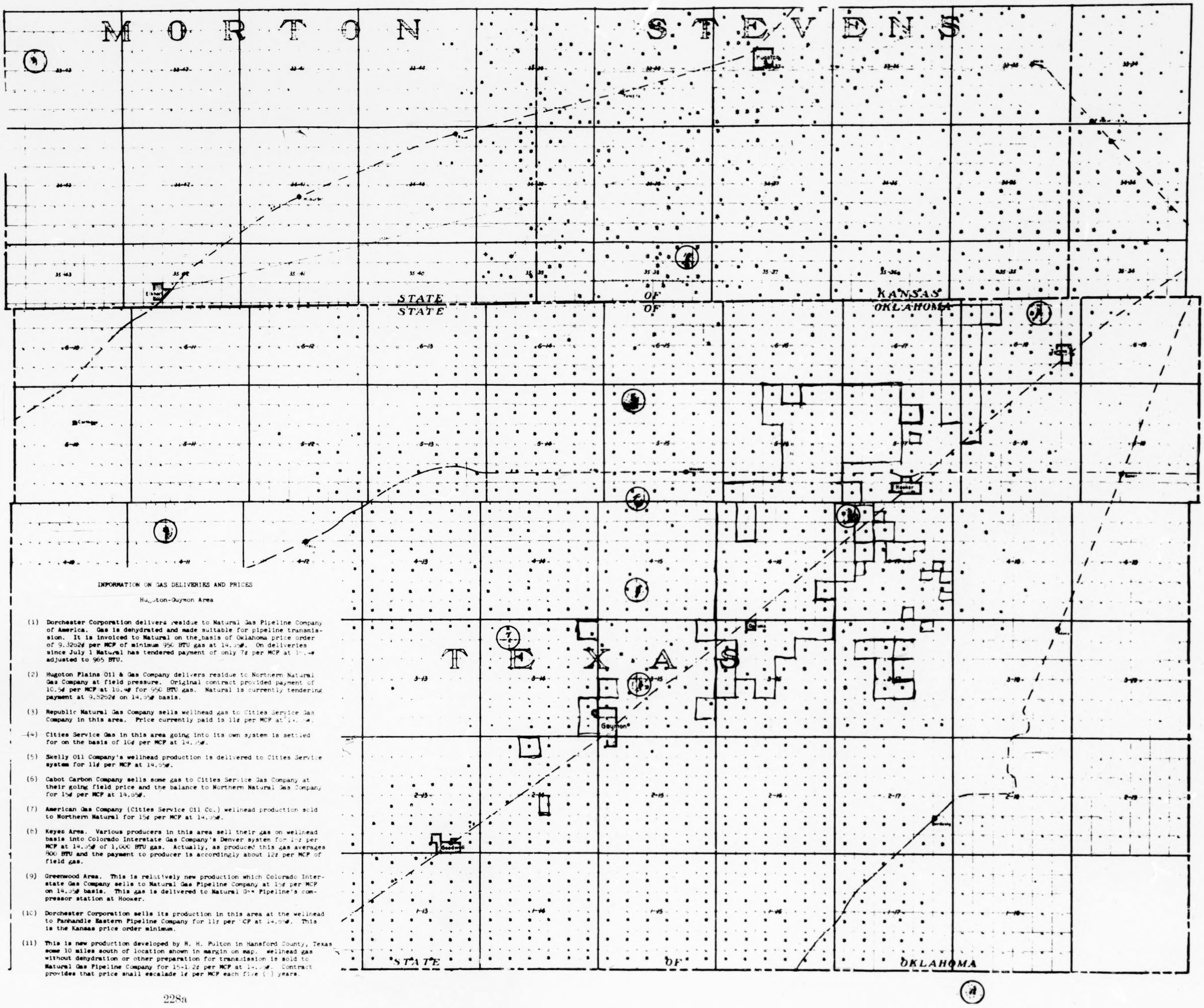

INTERSTATE GAS CO
LAS ANIMAS
COLORADO
KANSAS-HUGOTON FIELD
Weighted Average Well-Head Price 11.538¢ At 14.65 PSIA. Avg. B.T.U. 1010
OTIS FIELD
NORTHERN NATURAL GAS CO
K A N S A S
DODGE CITY
CITIES SERVICE
NORTHERN NATURAL GAS CO
GREENWOOD FIELD
Purchases At Field Average Of 13.43¢ 14.65 PSIA Average 980 BTU Delivered By C.I.G. To N.G.P.L. Co At Hooker
KEYES FIELD
Weighted Average Well-Head 15¢ @ 1000 B.T.U. 12.28¢ 800-825 Average BTU 14.65 PSIA
GREENWOOD FIELD
LIGHT FIELD
P.E.P.L. Co. Purchase At 14¢ On 14.65 PSIA 1000 BTU
LIGHT FIELD
KEYES FIELD
Hooker Delivery Point To N.G.P.L. Co Average B.T.U. 965.
OKLAHOMA-HUGOTON FIELD
Weighted Average Well-Head Residue Price 10.163¢ 14.65 PSIA 950 Average B.T.U.
HUGOTON FIELD
PANHANDLE EASTERN
NATURAL GAS PIPE LINE CO
NORTHERN NATURAL GAS CO
CAMRICK FIELD
CAMRICK FIELD
N.G.P.L. Co. Purchases At 16¢ @ 14.65 PSIA 1000 BTU
HANSFORD FIELD
HANSFORD FIELD
N.G.P.L. Co. Purchases At 15¢ At 14.65 PSIA For 1000 BTU Average BTU 1000+
NEW MEXICO
DALHART
CITIES SERVICE GAS CO
OKLAHOMA
PANHANDLE
FIELD
FRITCH STATION
PROPOSE PIPELINE OF N.G.P.L. CO TO JACK AND WISE CO'S TEX DOCKET G-4280 START PRICE 15¢
AMARILLO
N.G.P.L. Co Buy From Phillips At 14¢ @ 14.65 PSIA Average BTU 1045
TEXAS
FEDERAL POWER COMMISSION
IN THE MATTER OF
DORCHESTER CORPORATION
DOCKET NO. 6505
EXHIBIT NO. ___



NOTE: All Prices Computed At Pressure Base Of 14.65 # sq. in. Absolute Unless Otherwise Indicated

FEDERAL POWER COMMISSION
IN THE MATTER OF
DORCHESTER CORPORATION

DOCKET NO. 6505
EXHIBIT NO. ____



INFORMATION ON GAS DELIVERIES AND PRICES

Hugoton-Guymon Area

(1) Dorchester Corporation delivers residue to Natural Gas Pipeline Company of America. Gas is dehydrated and made suitable for pipeline transmission. It is invoiced to Natural on the basis of Oklahoma price order of 9.32o2¢ per MCF of minimum 950 BTU gas at 14.65#. On deliveries since July 1 Natural has tendered payment of only 7¢ per MCF at 10.4# adjusted to 965 BTU.

(2) Hugoton Plains Oil & Gas Company delivers residue to Northern Natural Gas Company at field pressure. Original contract provided payment of 10.5¢ per MCF at 10.4# for 950 BTU gas. Natural is currently tendering payment at 9.52o2¢ on 14.65# basis.

(3) Republic Natural Gas Company sells wellhead gas to Cities Service Gas Company in this area. Price currently paid is 11¢ per MCF at 14.65#.

(4) Cities Service Gas in this area going into its own system is settled for on the basis of 10¢ per MCF at 14.65#.

(5) Skelly Oil Company's wellhead production is delivered to Cities Service system for 11¢ per MCF at 14.65#.

(6) Cabot Carbon Company sells some gas to Cities Service Gas Company at their going field price and the balance to Northern Natural Gas Company for 15¢ per MCF at 14.65#.

(7) American Gas Company (Cities Service Oil Co.) wellhead production sold to Northern Natural for 15¢ per MCF at 14.65#.

(8) Keyes Area. Various producers in this area sell their gas on wellhead basis into Colorado Interstate Gas Company's Denver system for 1o¢ per MCF at 14.65# of 1,000 BTU gas. Actually, as produced this gas averages 800 BTU and the payment to producer is accordingly about 12¢ per MCF of field gas.

(9) Greenwood Area. This is relatively new production which Colorado Interstate Gas Company sells to Natural Gas Pipeline Company at 15¢ per MCF on 14.65# basis. This gas is delivered to Natural Gas Pipeline's compressor station at Hooker.

(10) Dorchester Corporation sells its production in this area at the wellhead to Panhandle Eastern Pipeline Company for 11¢ per MCF at 14.65#. This is the Kansas price order minimum.

(11) This is new production developed by R. H. Fulton in Hansford County, Texas some 10 miles south of location shown in margin on map. Wellhead gas without dehydration or other preparation for transmission is sold to Natural Gas Pipeline Company for 15-1.2¢ per MCF at 14.65#. Contract provides that price shall escalade 1¢ per MCF each five (5) years.

Office - Supreme Court, U.S.
FILED
MAY 14 1958
JOHN T. FEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

NO. 1003

DORCHESTER CORPORATION,

Petitioner,

v.

NATURAL GAS PIPELINE COMPANY OF AMERICA,
FEDERAL POWER COMMISSION,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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BORG PRINTING COMPANY OF TEXAS, HOUSTON, TEXAS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. .....

DORCHESTER CORPORATION,

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NATURAL GAS PIPELINE COMPANY OF AMERICA,
FEDERAL POWER COMMISSION,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Dorchester Corporation ("Petitioner") prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in the above entitled cause on February 26, 1958.

OPINIONS BELOW

The opinion and judgment for the Court of Appeals for the Third Circuit of February 26, 1958, is not yet reported, but is printed as Appendix "A" hereto, *infra* pp. 18-31. The orders of the Federal Power Commission which formed the basis for this action are printed in chronological order in Appendix "B" hereto, *infra* pp. 32-42.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1958. A Petition for Rehearing was filed by Petitioner on March 28, 1958, and was denied on April 10, 1958. Jurisdiction of this Court is invoked under 28 U.S.C. 1254(1), and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Whether the Oklahoma minimum price law constituted a valid exercise of state regulatory power over matters of local concern prior to the time that the paramount federal authority was implemented by the Federal Power Commission in its Series 174 orders[1] issued during the summer and fall of 1954.

2. Whether the Court of Appeals in modifying the order of the Federal Power Commission exceeded its judicial function and invaded the administrative province.

STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act, 52 Stat. 821, 15 U.S.C. 717, et seq., are set out in Appendix "C" hereto, *infra* pp. 43-48.

STATEMENT OF THE CASE

Respondent, Natural Gas Pipeline Company of America ("Natural"), entered into a contract with Harrington & Marsh, a partnership, effective December 1, 1946, for the purchase and sale of gas from the Guymon-Hugoton Field in Texas County, Oklahoma (R. 1006). The contract pro-

[1] Order No. 174 was issued July 16, 1954; Order No. 174-A was issued August 6, 1954, and Order No. 174-B was issued December 17, 1954.

vided for a sale of 84,000,000 cubic feet of gas per day (pressure base of 14.65 psia) until January 1, 1965, and thereafter until cancelled by Natural. Furthermore, this agreement expressly provided that it was subject to and modified by future valid regulatory orders.[2] On October 1, 1948, Panoma Corporation succeeded to the interest of Harrington & Marsh under the contract. On July 29, 1952, the Oklahoma Corporation Commission fixed a minimum price of 9.8262 cents per Mcf for all gas removed from the Guymon-Hugoton Field (Order 26096). Natural commenced to pay in accordance with this minimum price order but initiated an appeal therefrom.

Pending appeal, on July 1, 1954, Petitioner acquired certain rights in the properties formerly held by Panoma Corporation and in the gas purchase contract (R. 453-455). By means of a complex financial transaction, Petitioner became the nominal party seller under the gas purchase contract, but was in reality the owner of and entitled to receive only 3½ per cent of the proceeds of the payments made for the gas and the 45 per cent interest in the liquids attributable to the leasehold estate after all royalties, overriding royalties and other payments to which the leaseholds were subject were made. Natural, as purchaser of the gas, assented to the transaction and was supplied with copies of all the documents pertaining thereto prior to

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[2] Article Fourteenth in full reads:

"Contract Subject to Laws and Regulations.

"This contract is subject to present and future valid laws and present and future lawful orders of all regulatory bodies now or hereafter having jurisdiction over the parties; and should at any time during the term of this contract either party, by force of any such law or regulation imposed, be ordered or required to do any act inconsistent with the provisions of this contract, the contract shall, subject to the other provisions hereof, continue nevertheless, but shall then be deemed modified to conform with the requirements of such law or regulation."

effectuation thereof on July 1, 1954 (R. 239). At the time of closing, on July 1, 1954, and on June 7, 1954, Natural was invoicing and paying for the gas sold and delivered to it by Panoma at a price of 9.8262 cents (R. 329-338-759).

By the terms of order No. 174 (as superseded by order No. 174-A and No. 174-B) independent producers were required to file on or before December 1, 1954, rate schedules, as defined in Section 154.93 of the Commission's regulations under the Natural Gas Act, setting forth the terms and conditions of service and all rates and charges for such transportation or sale *effective June 7, 1954.* Since Petitioner was the nominal party seller under the gas purchase contract, it filed with the Commission the contract and all amendments and supplements thereto, including the Oklahoma minimum price Order 26096 that became effective August 1, 1952, and which was in full force and effect on June 7, 1954 (R. 185-186).

On December 30, 1954, the Commission issued its order allowing Petitioner's filed rate of 9.8262 cents to become effective (R. 1091). Natural commenced making payments at the rate of 9.8262 cents. By allowing Petitioner to file the Oklahom minimum price as the rate legally in effect on June 7, 1954, the Commission simply followed the policy it had established in regard to all other sellers of gas in the Guymon-Hugoton Field, as it had uniformly allowed the rate of 9.8262 cents to be filed by such sellers where it was higher than the contract price (R. 22-23, 572-573, 604, 631).

In *Natural Gas Pipeline Co.* v. *Panoma Corp.*, 349 U.S. 44 (April 11, 1955), this Court held the Oklahoma minimum price law invalid because it conflicted with the paramount federal jurisdiction as initially implemented by the Commission in its Order No. 174 issued July 16, 1954. However,

this Court made no determination as to *when* such order became invalid. Thereafter, on November 14, 1955, the Commission found that the 9.8262-cent rate was the one effective and applicable under the contract *on June 7, 1954.* This decision was reaffirmed in its orders of January 5, 1956, February 3, 1956, and February 24, 1956.

Natural initiated this appeal to the United States Court of Appeals for the Third Circuit, claiming that the Oklahoma minimum price law fixing the 9.8262-cent rate was invalid on June 7, 1954, and that therefore the Commission's action in approving such price permitted Petitioner to obtain a higher rate through a unilateral filing, contrary to the decision of this Court in the *Mobile* case.[3]

On February 26, 1958, the Court of Appeals held that the lawful contract rate on file June 7, 1954, was 6.253 cents per mcf and that therefore the Commission's order of January 5, 1956, should be modified to provide that effective as of that date the rate of 6.253 cents per mcf be reinstated for the period prior to March 1, 1955, and that paragraph (D) of said order be modified to direct Petitioner to refund to Natural the difference between 10 cents per mcf and 6.253 cents per mcf for the period from March 1, 1955, to January 5, 1956. The court further set aside the order of the Commission of February 24, 1956. On April 10, 1958, the Court of Appeals overruled Petitioner's Petition for Rehearing.

REASONS FOR GRANTING THE WRIT

A. This request for review presents important federal questions which are derived from the complex administrative problems surrounding the regulation of independent producers of natural gas by the Federal Power Commission.

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[3] *United Gas Pipeline Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956).

The determination of these questions not only vitally affects Petitioner and its ability to render service to Natural, but likewise affects all other sellers of gas in Oklahoma and Kansas who received payments in excess of their contract prices pursuant to the minimum price laws promulgated by the regulatory agencies of those states. Such payments were received with the assurance of this Court in *Cities Serv. Gas Co.* v. *Peerless O. & G. Co.*, 340 U.S. 175 (1950), that minimum price laws were a proper exercise of state regulatory power.

When the regulation of independent producers was thrust upon the Commission by the decision of this Court in *Phillips*,[4] the treatment of the state minimum price laws, which were admittedly passed in the aid of conservation and to prevent waste,[5] was just one of the many vexing problems presented to the Commission. Therefore, the Commission resolved that until further study and consideration, it would attempt to preserve the status quo of all prices being paid on June 7, 1954, and accordingly required independent producers to file the prices which they were receiving on that date. Petitioner filed the 9.8262¢ rate which it was receiving pursuant to the Oklahoma minimum price law. The Commission accepted this filing and like filings made by producers whose rates were subject to the Oklahoma and Kansas minimum price orders.

On appeal, the court below determined that the Oklahoma minimum price law was invalid on that date and ordered the 6.253¢ rate to be reinstated. The Court of Appeals relied upon the decision of this Court in *Natural Gas Pipeline Co.* v. *Panoma Corp.*, 349 U.S. 44 (April 11, 1955), wherein it was held that the Oklahoma minimum price law was invalid

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[4] *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

[5] *Cities Serv. Gas Co.* v. *Peerless O. & G. Co., supra; Phillips Petroleum Co.* v. *Oklahoma*, 340 U.S. 190 (1950).

because it conflicted with the paramount federal authority as implemented by Order No. 174 issued by the Federal Power Commission on July 16, 1954. This was an erroneous interpretation of the *Panoma* case, for in that decision there was no determination as to *when* such state minimum price regulation became invalid. Therefore, this Court is now confronted with the issue of whether state minimum price laws were invalid during the period prior to the regulation of rates of independent producers by the Federal Power Commission, i.e., prior to July 16, 1954, when the federal jurisdiction was first implemented by Order No. 174. As recognized by the court below in the initial sentence in its opinion, "the dispositive question here is what was the lawful contract rate on June 7, 1954," for gas sold by Petitioner to Natural? The answer to this question is dependent upon a determination of whether Congress intended to preclude such state action by the mere enactment of the Natural Gas Act, and thereby create a hiatus until the Commission acted, or whether the existing state power was to remain unimpaired until the Commission implemented its jurisdiction. This is an important federal question with industry-wide consequences which urgently calls for determination by this Court at this time.

The administrative problems that are faced by the Commission as a result of the decisions by this Court without further clarification thereof, are well evidenced by the "Notice of Proposed Rule Making" issued by the Commission on April 28, 1958, in Docket No. R-168. A copy of such notice is attached hereto as Appendix "D". In its notice, the Commission states as follows:

> "Among those questions which the Commission is considering in this connection which appear to be raised by the decisions of the Supreme Court referred to, are: